



“Customer Relationship Management (CRM) in Financial Services”

Special Notices

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ABSTRACT

Today, many financial services organisations are rushing to become more customer focused. A key component of many initiatives is the implementation of Customer Relationship Management (CRM) software. Our research has highlighted that most institutions take a rather narrow view of CRM and as such benefits have been limited. While second generation CRM has emerged to embrace the total organisation (hence Enterprise CRM), success in general has still not been widespread. In this paper, a framework is presented which is based on incorporating e-business activities, channel management, relationship management and back office/front office integration within a customer-centric strategy.



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Customer Relationship Management (CRM) in Financial Services

Once upon a time retailers, banks, insurance companies and car dealers had a close relationship with their customers. They often knew them individually, understood what they wanted and satisfied their needs through personal customised service. As a result, they earned loyalty and a large share of their customers' business. This, however, was a costly and inefficient system and customers effectively subsidised this relationship by paying higher prices. Over the years, through mass marketing and increased consumerism customers traded relationships for anonymity, reduced variety and lower prices.

Today, through the effective use of information and communications technology, such a tradeoff is no longer necessary; organisations can offer their customers variety, lower prices and personalised service, all at the same time. An airline gate attendant whom you have never set eyes on knows you are a valuable customer and upgrades your seat to first class in preference to a once-a-year holiday traveler. Your garage reminds you that your car is due for service. A car hire company takes your reservation on a dedicated line, then presents you with a waiting rental car complete with your name in lights when you arrive at your destination. Your bank informs you that you have excess funds in a non-interest bearing account.

These companies are practicing elements of an approach to marketing that uses continuously refined information about current and potential customers to anticipate and respond to their needs. This is the practice of Customer Relationship Management (CRM).ⁱ Many businesses today realise the importance of CRM and its potential to help them achieve and sustain a competitive edge. These organisations are already changing their business processes and building technology solutions that enable them to acquire new customers, retain existing ones and maximise their lifetime value.

Although CRM is a recent concept, its tenets have been around for some time. Marketers have always promoted close relationships with customers.ⁱⁱ Customer profitability has been touted as significant for many years, but has been difficult to determine as many institutions are organised along product or channel lines as opposed to customer. Similarly, the concept of mass customisation has been in the literature for nearly a decade.ⁱⁱⁱ However, all have remained essentially theoretical concepts; aspirations rather than practical or commercial realities. Today, due to advances in information and communications technology, the promise of one-to-one relationships, customer-value analysis and mass customisation are now possible. Yet, despite the role of technology these manifestations are less of a technological phenomenon than a profound

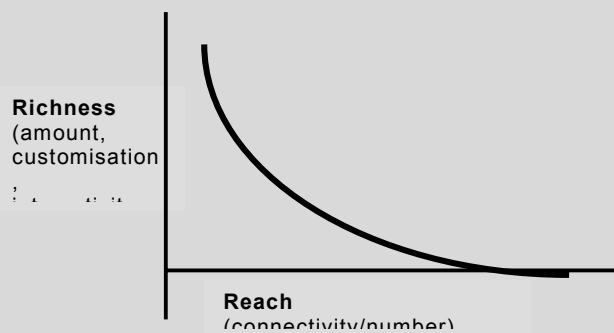
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change in the economics of information (see box 1).^{iv} A new business ecosystem is emerging.

Box 1 The new economics of information.

The new marketplace is characterised by a change in the economics of information. The traditional economics of information can be represented by a trade-off between the richness of information and reach of message.¹ Reach is about access and connection; it means how many customers a business can connect with and how many products it can offer to those customers. Richness is the depth and detail of information that can be given to customers as well as the depth and detail of the information collected about customers.

The conventional economics of information dictates that information rich in dialogue, customisation and interactivity can only reach a limited audience. For example, the traditional sales pitch to a client usually includes a presentation, perhaps incorporating video and other client testimonies; questions can be posed and answered in an interactive session. The reach, or audience connected to, is one company but the richness of the information exchange is huge, particularly when compared to that on a typical newspaper advertisement. Using this media, the advertiser has to be very selective on the amount of information displayed on the ad as space is limited, but it does however reach a mass audience.



Today, sophisticated technologies like the internet, Digital TV, and wireless telecommunications mean that this trade-off, illustrated by the curve in the above diagram, is now not necessary. A rich message can potentially be conveyed to a wide base of customers. These newer technologies define an environment that is fundamentally different from older technologies in a number of ways. And it is in this new environment or “ecosystem” where the old rules of business no longer hold.

The technologies available today are different in three respects to those of the past. They permit an increased connectivity capability; distinctions between different technology types are blurring; and technology is now interactive.

Connectivity. Today it is relatively easy and cheap to connect to global networks, resulting in the PC and mobile phone emerging as ubiquitous devices. One of the consistent lessons of technological innovation is that the emergence of standards stimulates both uptake and investment and

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this has characterised technological developments during the 1990s. It is now accepted that the value of the network increases with an increase in numbers, often referred to as the phenomenon of “network externalities”; imagine being the first person with a fax machine or a mobile phone? The value of a networked good, such as a telephone or PC, increased as to the square of the number of other people in the network. For example, a network with a node of one has a value of nil; a network with two nodes has a value of one; a network of three nodes has a value of three; a network of 7 nodes has a value of 21, and so on.

Convergence. Digital technologies themselves are converging. The emerging Wireless Application Protocol (WAP) technology, for example, permits internet access using the wireless cellular network blurring further distinctions between fixed and mobile technologies.

Interactivity. New technology provides for true interactivity. This interactive element is of crucial importance since much business activity consists of interactions (human and technical communication, data gathering, collaborative problem solving and negotiation). Indeed, a recent McKinsey report suggested that 51% of US and 46% of German labour costs are accounted for by interactive events.² Interactivity today allows the customer to shape the product or service and the supplier to learn from the customer.

¹ P.B. Evans and T.S. Wurster, ‘Strategy and the new economics of information’, *Harvard Business Review*, September-October, 1997, pp. 71-82; P.B. Evans and T.S. Wurster, ‘Getting real about virtual commerce’, *Harvard Business Review*, November-December, 1999, pp. 85-94. ² P. Butler, T.W. Hall, A.M. Hanna, L. Mendonca, B. Auguste, J. Manyika and B. Sahy, ‘A revolution in interaction’, *The McKinsey Quarterly*, Vol. 1, 1997, pp. 5-23.

The effective management of information has a crucial role to play in CRM. Information is critical for product tailoring; for service innovation (e.g. tailored websites); for providing a single and consolidated view of the customer; for calculating customer lifetime value; for establishing an integrated multi-channel capability. Yet it is not just about having better customer information and perhaps then being able to offer new services (e.g. prompting customers to transfer money if they build up a large balance on a non-interest-bearing account) but also personalising the transaction. The customer should be known everywhere – if they phone, if they go to an ATM, if they use the internet or if they visit a different branch. This concern for consistency of service across channels is becoming a recurring theme propagating the imperative for an integrated channel.

Although a recent phenomenon, the CRM concept has already been extended to include the whole enterprise in dealing with customers and ECRM (where E = enterprise) has emerged as its current manifestation. Research to date would suggest that financial institutions in particular must adopt an enterprise-wide perspective, with front office/back office integration, if they are to become truly “customer-centric” and capitalise on the opportunities provided by the information which this makes available to them.

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Our research has highlighted that most financial service organisations have a rather narrow view of ECRM. For some, ECRM is seen as a technology solution rather than a strategy. Software packages are chosen to overcome the problems inherent in incompatible legacy IT systems, often due to merger and acquisition activity, where providing a consolidated view of the customer is difficult if not impossible, severely implicating frontline staff in their interactions with customers. The CRM solution is seen as providing the platform to provide an integrated view of the customer. In other organisations, the ECRM project is driven by the requirements of one function rather than as part of an overall enterprise-wide customer-centric strategy. In essence, this manifests the fact that despite the many re-engineering initiatives that have taken place in financial services institutions over the last decade, different departments within an organisation still operate as silos and consequently horizontal end-to-end customer processes are still not well understood or defined. In an increasing number of organisations the CRM initiative is being driven by the marketing department who see the end result of a repository of customer information and wish to utilise data mining techniques to extract patterns from this data for decision-making purposes in marketing.

Yet, European financial service institutions can deliver value from their ECRM investments, but to do so they must take a broader perspective of the concept.^v Our research suggests that such a comprehensive perspective can be captured using the acronym ECRM but where these letters denote four central concepts. These concepts are:

E: **E-business** and more importantly the integration of e-business activities within the framework of all existing and future commercial activities.

C: **Channel management** – the channel of greatest impact or economy anytime, anywhere and anyone – integrated and interactive channels of access and distribution.

R: **Relationships** – real commercial relationships built on service excellence, value and convenience.

M: **Management of the total enterprise** – total back office/front office process integration.

In the remainder of this paper we develop these four concepts in the context of a CRM initiative. While the focus is on financial services organisations, many of the issues are equally relevant for other industries. We illustrate how each of the four concepts is challenging traditional players and suggest how they might be addressed.

E-business

There has been tremendous hype surrounding the concept of e-business^{vi}, much of it fueled by technology vendors and a media feeding frenzy the like of which has not been seen before. One only has to pick up a newspaper to see the variety of 'e'-related stories and advertisements. While there is a changing world out there it is important to maintain a sense of proportion and reality and be clear as to what it is that is changing.

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The word 'e-business' itself is something of a misnomer. The word as spoken in general parlance is generally used without any real clarity, in an almost flippant way as if everyone understands what it means. From our experience this is not the case; asking a group of managers what e-business means to them usually results in a wide variety of responses.

In its current manifestation, e-business falls into two broad categories. First is the use of technology to re-engineer business processes that are primarily *internal* to the organisation. This could entail using component-based technologies to develop a new life and pensions application or developing a web-based loan processing application on the corporate intranet. Second, it relates to the use of technology in how the organisation interfaces with business partners whether they are customers or suppliers – an *external* focus. For example, in enabling customers to transact business over the internet or establishing a new organisational model, in what has been referred to as a “virtual” organisation.^{vii} In reality, e-business-labelled initiatives in organisations generally exhibit attributes of both these categories. As a preliminary perspective of e-business, it is concerned with an organisation establishing an electronic business platform within a strategic business context.

Creating this platform is somewhat similar to developing an IS/IT strategy, which many organisations have done for the last 30 years. Technology may be more sophisticated than it was back then but the basic premise still holds: an organisation should examine technological advancements in developing its business strategy and articulate how technology will support its strategic thrust. This, however, is more than mere alignment of IT investments with business strategy; the duality of technology is that it enables strategies as well as creates strategies.

Unfortunately, many organisations have mistakenly sought to develop a separate e-business strategy in order to conquer this revolution. An e-business strategy should *not* be seen as an adjunct to the business strategy but become an integral part of the business strategy. We firmly believe that when the hype dies down that the “e” will be dropped and that there will be no false distinction between *business* and *e-business*; it will all just be considered business. This inclusive strategy of the business will incorporate the opportunities provided by technology, enabling the organisation to establish the electronic business platform that is fully integrated into its business model. Business is converging with technology and the message is no different from that of the “IT and competitive advantage” argument of the 1980s: technology decisions are essentially business decisions.^{viii}

The new business ecosystem

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The new economics of information creates a new business environment – a new ecosystem. What is different today, and this is the central aspect, is that more and more business gets transacted in a computer-mediated environment; and this environment *is* significantly different from the physical world. It represents a shift from conducting business transactions in the physical “marketplace” to the virtual or cyber “marketspace”. This new space has also been referred to as the New Economy.^{ix}

Conducting business in this ecosystem has tremendous implications for the rules^x and traditional practice of business^{xi} as well as overall market efficiency.^{xii} Internet trading, for example, is rewriting investing rules in the US and Europe^{xiii}; capital markets, it is argued, will become more liquid and efficient.^{xiv} The “ecosystem” of the New Economy *is* different and operating in this new ecosystem presents both opportunities and threats for traditional financial service industry players and indeed for our current understanding of the industry.^{xv} Cognisance and due recognition must also be given to the rapid deregulation and economic restructuring taking place in Europe in both financial services and telecommunications as well as increased globalisation which are further impacting the financial services industry and adding to the turmoil.^{xvi}

The evidence to date suggests that traditional business models are unlikely to translate profitably into the new ecosystem.^{xvii} The prescription is that organisations should look for new opportunities provided by new technologies. Competing and operating in the marketspace opens up a wide range of strategic options and opportunities for innovative products and services and the creation of new business models. Examples include:

- Establishing e-banks with no presence in the physical world
- E-billing or electronic bill presentation^{xviii}
- Banks establishing online purchasing sites^{xix}
- Issuing e-bonds^{xx}
- Virtual wallets^{xxi}

The original e-banking route relied on a PC and modem for direct access to bank accounts. The service generally provided poor functionality and customers normally had to download account details into additional money-management software. The internet, with its interactive capabilities, enables banks to provide a significantly enhanced service.

The first internet bank to provide electronic banking was Security First Network Bank in October 1995. Since then many more institutions have followed. European institutions in general (with the exception of Scandinavian countries – see box 2) had initially been slow to respond to opportunities provided by the internet but have since gathered momentum. The UK’s Barclays Bank, Germany’s Commerzbank and Bayerische banks, Norway’s Christiana bank, and Credit Suisse all have internet offerings.

But activity should not be confused with success. Recent research in the UK suggests that the financial services industry is investing in e-business

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as an “act of faith”, motivated by the fear of being left behind with little knowledge of the eventual value of the investment.^{xxi}

Box 2 MeritaNordbanken.

Finnish banks were looking at ways to push out from “Bricks and mortar” well before the banking crisis of the early 1990s forced banks to radically reassess their cost bases. Electronic means of banking have proved such a success that cheques have been a rarity in Finland since the end of the 1970s when most other European Banking systems were still swamped by paper.

MeritaNordbanken, Finland’s largest bank formed from the merger between Finland’s Merita Bank and Nordbanken of Sweden in 1997 is arguably the most developed electronic bank in the world. It offers customers a large array of e-banking access devices, a multitude of customer-centric financial offerings and has developed its business strategy to leverage its existing retail customer base to offer value-added services to its corporate clients. It brought in telephone banking in 1982, PC banking in 1984 and investments trading in 1988. In 1992, a mobile payments service was added to the overall mix.

The move into open e-business networks took place in 1996, which by the end of the year netted Merita 250,000 internet banking customers. Two years later, e-billing and internet TV were added and the bank developed a set of electronic identification and signature codes that customers could use across the various access platforms.

Merita’s e-banking customers can access their online account via payment ATMs, telephone, GSM mobile, PC, internet TV, and soon, wireless application protocol (WAP) interactive mobile phones, making its access mix one of the richest in the world. It offers basic banking, stock trading, investment fund transactions, purchase and sale of bonds, account opening, credit cards ordering, credit card transactions viewing, general bill balances via GSM mobile and loan authorisation guaranteed within one hour – without any paperwork being signed. It has established open pages geared to building up life-event combinations to avoid offering straight deposits, loans and payment products. They approach it from a person’s life events, such as studies, going abroad, retirement, the need to move somewhere, and so on.

Merita has 600,000 Finnish internet banking customers, 500,000 of which actively use the service on a monthly basis, representing 42% of its retail customer base in Finland. The take-up rate is about 15,000 customers per month and the current monthly logon is two million per month, or four logons per active customer. 26% of all bill payments – 1.5 million per month – take place via the internet.

Operating in this new ecosystem has a number of implications. These are:

- Reduced cost of business
- Increased service levels
- Reduced entry barriers
- Extended global reach
- Challenged brands

- Bundled and unbundled products and services
- Change of location
- Power and control returned to the customer

In the remainder of this section these implications are examined.

Reduced cost of business

Many financial organisations have been re-engineering their core business processes over the last decade.^{xxiii} This has led to cost reductions, and in some cases these have been quite significant. Yet even today, many banks still have a high cost-income ratio. Even highly efficient banks such as Bank of Scotland and Lloyds TSB have ratios around 50% (49.5% and 46.6% respectively). At Deutsche Bank, the ratio in 1998 climbed to 78%.

New distribution channels provide opportunities to reduce the costs of processing transactions. It is estimated that the cost differential between transacting business in a branch and over the internet is quite significant (see table 1).^{xxiv} Branches are increasingly being considered a cul-de-sac, and by pruning the branch network, it is argued that banks could immediately reduce their cost structure.

Delivery mechanism	Transaction (Stg£)	costs
In-branch teller		1.20
ATM		0.40
Telephone		0.30
PC Banking		0.20
Internet banking		0.01

Table 1 Service delivery channels and associated transaction costs.
Source: Datamonitor, 1999.

From a customer perspective savings can be equally significant. Over the last three years the cost of buying and selling shares has been impacted by the Internet. While traditional brokerages charge a commission of 1 % to 2 % on the value of every trade, companies like datek.com offers trading at \$9.99 per trade no matter what the value of the trade is and there are suggestions that in the near future trading will be for free.

E*Trade was established as a pure internet-only operation which enables stock transactions to be initiated. The fact that E*Trade has been electronic since its inception creates obvious cost efficiencies. Today, E*Trade is possibly twice as efficient as Charles Schwab in terms of the amount of trades per customer it could handle. Net.B@nk's (an internet-only bank) operating expenses are about half those of a comparable traditional bank so they can pay higher interest rates on accounts and avoid service charges.^{xxv} For the insurance industry, a big advantage of selling via the internet is that the client does the work and even pays the connection costs.

Increased service levels

The marketplace provides opportunities for banks to reposition existing products and services as well as devise new offerings, increasing the quality of service that they deliver to customers. An increasing number of retail banks are allowing customers to access account information directly from a PC or mobile phone. They can also move funds between accounts as well as pay bills or apply for overdraft facilities or loans online. Customers can now choose the channel of highest convenience with 24-hours-a-day availability.

Lowered entry barriers

One of the consequences of this new marketplace is that “pirates” can infiltrate the value chain of traditional players.^{xxvi} Just look at what Amazon.com has done for book retailing. Virtual banks can be established relatively easily; there is no need for an expensive “bricks and mortar” distribution system and already many traditional European banks are being caught off guard.^{xxvii} Net.B@nk is an internet-only bank. Retailer Tesco is planning to launch an online banking service linked to its fast growing internet home-shopping service.^{xxviii} Some established players, like the Halifax Building Society, see the internet as an opportunity to act like a new entrant.^{xxix}

E-loan.com, Mortgage.com and QuickenMortgage.com are the top three sites with regard to online mortgage provisioning in the US. None are traditional financial players. E-loan lets customers research more than 50,000 mortgage products from 70 lenders, then submit and track loan applications online. E-loan doesn't just offer a gateway to other lenders and their rates; it actually raises the money itself for the mortgages it provides. The company draws up its own loans, closes the loan, takes care of the fund-raising and the capital markets itself. While this type of lending is risky, E-loan claims to transfer credit risk to financial markets through securitisation.

While many German banks currently offer home banking via the internet, no German financial institution focused exclusively on the internet as the sole distribution channel until the arrival of Net.B@nk. Founded in 1998 by seven Sparda banks that capitalised Net.B@nk with DM20 million (\$11.03 million), the Hamburg-based company expects to attract 50,000 customers and grow at a net worth of Euro 600 million over the next five years. Currently, it has only ten employees and uses the back-office systems of the Sparda branches in Hamburg. Under the trademark “netgic”, Net.B@nk is offering basic banking plus non-financial third-party products. The core product is the “netgic” account. It includes a current account with an overdraft facility, a savings account, fixed term deposit and a transaction account for securities held on deposit.

The flip side of low entry cost, is that the significant marketing spend of financial entrants can itself become a barrier to entry.^{xxx} Many players argue that acquiring customers will never be as cheap; E*trade, for example, is spending \$300 million on advertising arguing that this investment will be a significant barrier to entry.

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However, traditional financial services organisations still have three huge advantages: brand (see below), capital and customer base. It is also possible that retail banks may be less vulnerable to online competition than stockbrokers. Share trading has little use for long-term relationships and trust while these are inherent in banking.

Extended global reach

Once established, a financial institution with a presence on the internet is a global player.^{xxxii} It has a footprint in a bigger marketplace than a branch in the physical world could ever hope to achieve. The flip side, of course, is that it faces competition from institutions operating out of a country never before considered as a source of competition. Today, for example, it is possible to trade stocks from European countries using the services of Datek, DLJDirect or Schwab, all US-based companies. Only a few banks are at present planning to use the net to do what no on-land bank has done: develop a pan-European bank. This is what first-e, a cooperation between Banque d'Escompt, a mid-sized French bank and ENBA, a Dublin-based developer of internet-only financial services, plans to do. Lloyds TSB have also announced plans to launch a pan-European internet bank as part of moves to shed its domestic UK bank image.^{xxxiii}

Challenged brands

The issue of branding is an interesting one when operating in the new ecosystem. Does the internet signal the death of traditional brands? Or do brands increase in importance? Strong brands instantly convey solid trust and trust is integral to effective customer relationships.

Confidentiality and security are components of the trust that is so essential to banking. How do you build this trust in the new ecology? In the physical world, trust is usually associated with animate objects, such as buildings and people. These aspects are absent in the virtual world and so present a challenge to the cybermarketer in the quest to establish brand equity. Researchers in consumer behaviour have found that consumers recognise differences in size and reputation among internet stores and that these differences influence their assessment of store trustworthiness, their perception of risk, and their willingness to shop with a particular store. A customer who believes that there is a physical branch (or chain) behind a website is more likely to trust the site on first encounter.^{xxxiii} Reputation and size are harder to convey and make close consumer relationships more difficult to develop in cyberspace than in traditional physical settings.

The evidence from early forays on the internet suggests that traditional brands may not necessarily translate very well to the new ecosystem. For example, American Express went into the online investing space with a fabulous financial services brand but was unable to make a success of it.

Bank One, the fifth-largest banking holding company in the US, recently launched WingspanBank.com as a separate site in direct competition with itself. Indeed, advertisements for the new bank criticise the poor service in bank branches! The new online service acts as banker, money manager, stockbroker and insurance agent. Customers can open checking accounts, pay bills online, apply for loans, and make and manage investments. It also searches the internet to help find the best deals on mortgages and insurance alerting customers through email when the best offer appears.

What is interesting is that it has been launched as a separate brand with its own identity. The company wanted a name that was internet-appropriate and stood out and also captured the depth and breadth of products and services offered. The group did not want any “baggage” inherent in the new brand. The company felt that if you try and extend Bank One or First USA (also part of the group) to places that consumers may not associate with either of those brands, it can create conflict and a lack of clarity about its purpose, creating confusion for customers.

WingspanBank.com is an integral part of Bank One’s multi-brand strategy designed to target a variety of customer segments with differing needs. Bank One also offers online services through bankone.com and FirstUSA.com. The different online banking initiatives will complement and compete with one another, providing products and services developed by both Bank One and third parties.

In the UK, Prudential have implemented a sub-branding strategy with Egg, its direct banking operation. The company has actively chosen to forgo short-term profits to acquire as many customers as possible. It is targeting a million new accounts within 12 months through a \$150 million marketing push. They believe that acquiring accounts will never be as cheap again, and as long as this trend continues, they will continue to invest in marketing. They have projected that the market will shake out and that the \$150 million marketing spend has raised the bar for new entrants.

Bundled and unbundled products and services

Financial services organisations have traditionally bundled their offerings to the marketplace. This permitted the cross-subsidisation of products and services and also provided them with critical mass. In the new business ecosystem, such offerings can now be unbundled, increasingly a competitive necessity given the rise in customer power (see below). Different institutions providing a variety of products and services are only a ‘click’ away and it is likely that customers will deal with many institutions in the future.

One emerging strategy is that online banks may concentrate on “integrated personal financial management” using technology to map the financial profile of customers and offer products that best meet their needs. In effect, institutions may re-bundle products to meet these needs but such products may not be actually provided by them. Consequently, institutions will no longer focus on cross-selling in the traditional sense. Today’s buzz word is open finance; firms no longer sell only their own

products but instead offer the best available, whoever the provider is – or risk losing customers.

Change in location

The mantra of the traditional retailer has been “location, location, location.” Choosing the wrong location can mean the difference between profitability and obscurity. Location is also important in the physical world because it is at the branch or office that the institution and the customer connect; it is where the customer has his or her account. In the new ecosystem the concept of location as currently conceptualised is irrelevant. Further evidence is provided by the fact that in many categories there isn’t a major e-retailer category in which a bricks-and-mortar retailer has a leading market share.^{xxxiv}

Power returned to the customer

Competing in the marketplace returns power and control back to the customer. The customer is no longer at the mercy of a single institution or operating in total ignorance. The marketplace customers can search for the best deals, often using the services of infomediaries^{xxxv} or electronic “go-between service providers”.^{xxxvi} For example, Homeshark, an internet-based mortgage broker, uses agent technology to search out the best deals for customers. InsWeb offers a best-quote search engine for insurance policies. Using reverse auctions it is only time before customers will post their financial requirements and financial institutions together with other non-banks will bid for their business and custom.

This rise in customer power is also amplified by the fact that competitors are only a “click away”. Retail banks, for example, have always operated on the premise that it was both difficult and inconvenient for customers to move bank accounts. “Word of mouse” is a potent force. As power continues to shift from seller to buyers, expect to see more widespread customer defections.

Customers are in control, particularly for commodity products. For more complex products like pensions, it is likely that the branch or agent will still provide the assistance necessary but technology could be used to enhance the relationship and help in cross-selling.

Channel management

Technology provides the financial service organisation with the capability to reach out to their customers through a variety of different channels. The advent of the internet, Digital TV, smart cards, GSM phones and kiosks holds the potential to radically alter the distribution channel landscape for retail financial services. No longer is it necessary for the banking business of the retail customer to be conducted in the high-street branch. Interactive televisions in homes across Europe, non-stop access to services and newly empowered consumers will have a major impact on financial services marketing. Financial services firms will have to

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develop a deeper understanding of these consumers in order to brand and target products accordingly. A proliferation of potential new distribution channels over recent years has elevated distribution channel strategy to the forefront of both business and IT managers' minds.

When Midland Bank (now part of HSBC) did research before establishing their telephone banking operation First Direct, they found some surprising results: one in five customers had not visited a branch in the last month, one in ten not in the last 6 months and one-half (51%) said they would rather visit their branch as little as possible. Many customers did not like the appointment systems and 48% had never met their bank manager.^{xxxvii}

Figure 1 captures the demands of today's customer, putting pressure on the old way of conducting business. The old business model was time and place restricted with the marketplace treated as a mass market. Customers today are more discerning, demanding to be treated as individuals and want to be able to engage in transactions from any place, at any time and from any location. In essence, they want to choose the channel of convenience whatever that channel might be. Financial institutions, particularly in retail banking, must respond to these demands. Those that don't risk losing in the new business ecosystem.

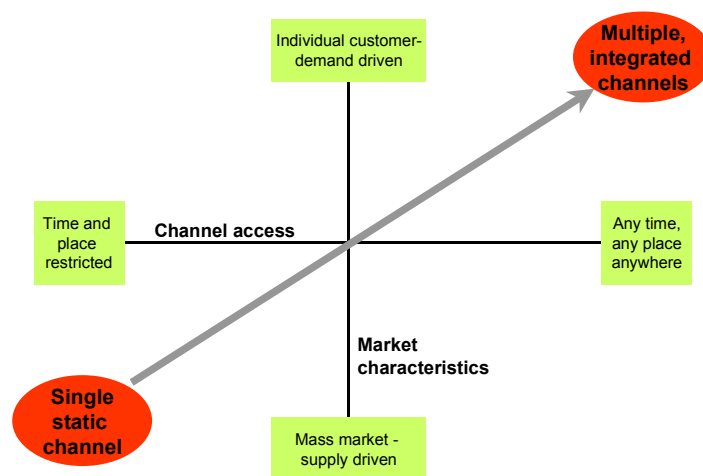


Figure 1 Requirement for new channels to market

Many institutions operate different channels and the information contained in them independently. An effective channel management strategy requires that all channels – the call centre, direct mail, branch, head office, internet and interactive TV (or transactional digital TV) – be fully integrated. This integration must produce an effortless sharing of knowledge about a customer's relationship with the company. Figure 2 illustrates the complexity of managing multiple channels across multiple customer contact points. The challenge is to devise a channel strategy which optimises cost and value.

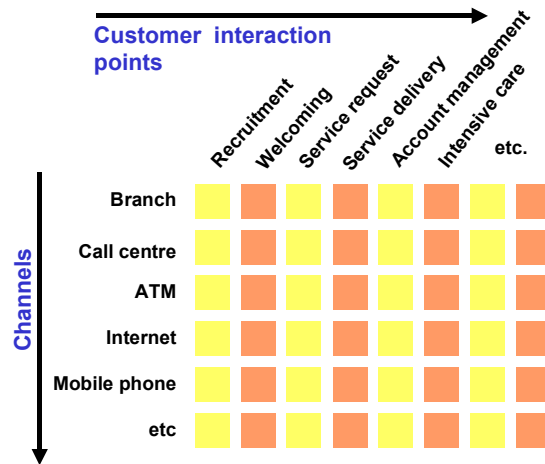


Figure 2 Channels and customer contact points

Delivery channels must be viewed in terms of appropriateness to the task that the customer wants to perform. By understanding customer usage of channels and building models that reflect customers' propensities, actions and needs, a financial institution can start to build the appropriate infrastructure to support their customers' changing needs and the financial institutions' economic needs.

The major cost advantages offered by direct channels outlined earlier must also be set against the loss of face-to-face interactions that was previously a key feature of the branch. Banks must remember the lessons from the introduction of ATMs 20 years ago. For many, this strategy was merely to "get the customer out of the branch", not realising the impact on relationship building and cross-selling. Although telephone banking offers an element of person-to-person interaction, it remains more suitable as a medium for product support and sales of commodity-based financial products, such as car insurance. Customers seeking to purchase high-value, complex financial products, such as pensions, are likely to continue to value face-to-face interaction of the branch environment.

Channel conflict

One discussion which institutions face when they establish an online presence relates to the impact of new distribution channels on existing channel revenue.^{xxxviii} Investing in an internet channel may mean embracing technologies that will destroy the value of past investments. There is also the likelihood of having to cannibalise existing business to build new business.

There will inevitably be channel conflict with the move to the web. For example, when an insurance company selling primarily through brokers and independent financial agents (IFAs) decides to sell directly to the consumer, what will be the impact of a new internet channel on the branch network? Barclays Bank is to close 200 branches as customers move to the internet and telephone banking.^{xxxix}

US share trade institutions have been reluctant to cut fees as Charles Schwab has done with its online trading operation. Charles Schwab established a separate online unit, e-Schwab, with its own staff, own offices and own sense of mission. And they did the unthinkable: they let eSchwab eat Schwab. The moment of truth came in late 1997 just as demand for eSchwab's \$29.95 online trades was booming beyond anyone's expectation. The problem was, customers with Charles Schwab's traditional brokerage still had to pay an average of \$65 per trade. The two-tiered pricing structure was awkward. The company made a radical decision: all trades would be at \$29.95. In essence, all of Schwab would become eSchwab. The price cut would shave an estimated \$125 million off revenues. In January 1998 when the price cut took effect, Schwab's stock lost almost a third of its value but total accounts climbed from 3 million to 6.2 million. The stock recovered. \$51 billion of new money poured in. The site now accounts for 42% of all web trades.

"Full service" stockbrokers, such as Merrill Lynch, are hampered by conflict between their channels of delivery. For a long time, Merrill Lynch resisted the move to go head-to-head with an internet channel (see box 3). Part of the reason was cultural, particularly when one realises that they had 17,000 commissioned brokers versus the 7,000 salaried brokers at Schwab.

Box 3 Merrill Lynch and Company

For a long time Merrill Lynch & Company ignored technology and the structural changes taking place in its marketplace. It is currently transforming itself into an 'internet-based firm'.¹ On the retail side, the company is probably two years too late in embracing the internet for trading and has lost ground to both its traditional competitors and newer 'pirates'. On the institutional side, the company is building a portal which will provide an array of services, enabling a corporate treasurer to do most of his business with Merrill Lynch at one web site, with one password. This system is an electronic replication of Merrill's global markets business which has 17,000 employees and \$6.5 billion in revenues. A critical challenge that the company faces is to integrate new online offerings with its existing on-land capabilities, its people and its offices. To attract more customers Merrill is trying to unlock the value of its analysts, bankers, traders and brokers by translating their knowledge and experience into content that can be tapped online.

¹ 'Merrill's Battle', *Business Week*, November 29th 1999, pps. 96; Tom Burns, 'Merrill Lynch focuses on affluent Europeans', *Financial Times*, November 25th, 1999.

One suggestion to overcoming the channel conflict problem is for an organisation to consider establishing a separate new business entity. Indeed, there is compelling evidence that organisations that have successfully built a strong market position in the face of disruptive, radically new technologies, have tended to do so by establishing an independent entity, at least in areas outside of financial services.^{x1} The Prudential's Egg Internet Bank, Bank One's WingspanBank, and Deutsche Bank's Bank24 are examples of organisations that have taken this route; only time will tell if it has been a successful strategy. The alternative to

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starting a new company is growing a reborn company within a traditional business.^{xli}

Channel integration

Channel integration is concerned with providing a common, consolidated and real-time view of the customer across all channels. From a customer perspective the channel they choose at any point in time should be the one of most convenience. Ideally, there should be no differentiation between the call centre, the internet or the high street branch. Indeed, the customer should be able to initiate a transaction in a call centre and perhaps complete it in a branch in a seamless fashion. All the information required to complete the transaction should be available at the point of customer interaction. The customer shouldn't have to deal with the consequences of organisational complexity (see box 4).

A channel strategy of the future will also see channels backing up each other. For example, the use of the call centre to back up the internet or Digital TV. A number of experiments are currently taking place which enable customers to quickly and easily access sales representatives when they are browsing internet offers. British Telecom has been working with both Eagle Star and Abbey National to introduce a "call me" button on their web sites. The customer enters their telephone number next to the product they are interested in. They press a button on the screen and the number is sent directly to the call centre's automatic cell distributor (ADC) which dials the number. The call centre computer telephony integration system displays the appropriate script on the agent's screen and they connect to the customer's number.

Box 4 Bank One

Bank One Retail Group has a strategy of ubiquitous distribution but in 1997 recognised that the internet was going to become an important channel in which they had no presence. They believed that their brand could not be ubiquitous if they were not a major player on the internet. Already, Citibank, Wells Fargo and BankAmerica were early leaders. The company quickly launched an online bank. Along the way they were the first bank to announce a pilot to fully integrate bill presentment into their online services. In November 1998, they announced a unique relationship with Excite, a leading Internet portal with 17 million users to create a full-service online financial centre. In early 1999 they became the first company to provide home equity loan decisions online within 50 seconds after an application was submitted in all 50 US states. Indeed, the day they announced the Loan-By-Phone, they received more online home equity applications than they typically receive in one month.

All the evidence would suggest that the branch is not dead; it is changing into just another channel. Technology that enables customers to use different channels enables innovative banks to create new face-to-face experiences in old and new settings. The prescription is for banks to focus less on reducing branch numbers as to determining what their role should be in the new ecology. The Woolwich, for example, is attempting to weave the branch into an integrated offering. It is rolling out a multi-channel personal banking service, Open Plan, which allows customers to use the

internet, telephone, branches and interactive digital TV to manage all accounts.^{xliii}

One of the more interesting developments in virtual banking is that some banks are establishing a physical presence.^{xliii} Ebank of Atlanta plans to open 24 branches, acknowledging that the lack of a branch network could impede account growth among small business owners, its target market. Intuit recently announced its intention to purchase Rock Financial. This deal will enable the company to fund mortgages from its web site rather than merely offer advice on third parties.



Relationship management

The original focus of CRM was to forge closer and deeper relationships with customers, 'being willing and able to change your behaviour toward an individual customer based on what the customer tells you and what else you know about the customer'.^{xliiv} The premise is that existing customers are more profitable than new customers; that it is less expensive to sell an incremental product to an existing customer; customer retention would be maximised by matching products and levels of service more closely to customer expectations; and attracting new customers is expensive. The central objective of CRM is thus to maximise the lifetime value of a customer to the organisation.

The evidence of having superior customer relationships is overwhelming:^{xliiv}

- relationship marketing increases retention. Research highlights that high levels of customer satisfaction are associated with increased retention of customers.
- relationships build more easily when there is two-way communication – and where organisations set up feedback loops, there is potential to learn from customers.
- relationship behaviour anticipates customer demands. By engaging in an interactive dialogue customer preferences can be determined.
- retained customers are inevitably more profitable. The research is clear that it costs much more to attract a new customer as it does to retain an existing customer; and that existing customers are more profitable. A knock-on effect is that the longer customers are retained, the greater is the opportunity for cross-selling.

In essence traditional CRM is about making it easier for the customer to deal with you; customers should not have to deal with your complexity, complexity which is often brought about by outdated structures, legacy systems and technologies. The customer should decide how they want to transact business and their preferred channel and not vice versa. Equally, it is about analysing customer information for business decisions: the aims being to help organisations understand customer needs; differentiate between customers via market segmentation; predict the likelihood of customer churn; perform analysis of customer loyalty, customer profitability, channel effectiveness and profitability and sales campaign performance. The challenge for an organisation is to move to a situation where the customer starts buying from you rather than being sold to.

Most financial institutions know implicitly that some customers are more profitable than others, yet many go on treating all customers in the same way. Many banks have thought that the 80/20 rule applied: i.e. that 80% of profits come from 20% of customers. In fact, some banks have found that high-profit households may in fact represent in excess of 100 % of profits because unprofitable ones subtract so much. Through customer profitability analysis, others have found that loyal customers are not necessarily profitable if they are also high users of the company's services.

There is a need to understand the value that current customers (potential long-term value) and potential customers can bring to a financial institution. Failure to take note of customer needs and the understanding that all customers cannot be treated in the same way can only lead to costly investment mistakes. Lenders such as Halifax and Abbey National in the UK have introduced schemes where borrowers can get better rates on their other products if they already have a mortgage. In an expression of its mutuality, Britannia Building Society gives customers a share of its profits each year, based on the size of their borrowing and how long they have been customers. Fidelity Investments implements a strategy of differentiated customer relationships, even prioritising and routing telephone calls at call centres on the basis of customer scoring.

E*Trade and other online financial services sites have turned the relationship between banks and customers on its head by empowering the consumer through the provision of real-time information, comparison tools and portfolio-tracking capabilities. Germany's Net.B@nk offers customers the ability to tailor-make their own web homepage; customers can retrieve information on about 250,000 stock prices and get news on political affairs, business, sport or cultural events. Banco Santander in Spain informs major credit card users of the status of their accounts as soon as they log on to its web site. Banks will increasingly use "push technology", such as on-screen ticker tapes, to inform the customer of new products or relevant account information such as excess cash in a non-interest-bearing account.

Viable customer relationships are based on data transformed into actionable information that in turn becomes customer insight ("knowledge") used to create predictive models for active customer interaction and actual dialogue if desired. Many financial organisations now use sophisticated profitability, potential and propensity models to determine how best to invest scarce marketing resources.

As marketing moves to a one-to-one environment, the need for large amounts of detailed information about customers is becoming essential. Without customer-level information and data on their transaction behaviour and their likelihood to repurchase and purchase additional products, one-to-one marketing programmes are not possible. Furthermore, as financial institutions begin to understand the profitability of their customers and need to focus resources on retraining and acquiring high profit customers, information on these customers is crucial in the delivery of a successful marketing strategy.

How can a retail bank truly understand and predict customers' needs to the point where it can design products and services that suit their needs? One way of looking at customers can be from the standpoint of channel usage. In the UK's Lloyds Bank/TSB merger, data were sourced from both their data warehouses, then used to segment the customer base by service channel usage. Customers were allocated to segments on their usage of the following channels: ATMs, automated (direct debits/standing orders), cards (credit and debit) and telephone.

Australia's St George Bank believed it could raise its conversion rate – i.e. the proportion of initial mortgage inquiries resulting in mortgages – so it tailored its services to match each customer's level of purchasing sophistication. Using a data warehouse, it categorises prospects as novices, enthusiasts, judicious buyers, investors and the indifferent. This allowed bank staff to respond in a way tailored to the customer, offering the most appropriate level of care and attention. A pilot study showed the conversion rate rising from 33 to 51 %, increasing profit while at the same time improving service to customers.

Theme-based marketing is being increasingly practiced by financial institutions.^{xvii} The belief is that consumers will no longer shop only for discrete products but for outcomes like a vacation or comfortable retirement. Theme-based marketing can be centered upon general lifestyles such as marriage or buying a home or life goals such as a comfortable retirement. British Airways offers loans to help people fund their vacations; the Woolwich are offering cars for sale that meet the needs and lifestyles of their customers. It is argued that financial services organisations are ideally positioned for theme-based marketing as they are seen as having the advantage of brand as the trust that derives from the traditional role as the family fiduciary.^{xviii}

Insurers (such as those in life assurance, personal non-life and health insurance) have tended to hoard extremely detailed records on their customers, claims and costs as islands of data held apart by a product-driven culture and separated into different areas such as accident, tradition and job protection. Having collected all this data about their customers and potential customers, they have all tended to disregard it as a source of competitive advantage or as a means of reducing cost.

Ironically, the actuarial staffs have built sophisticated models for pricing products and finance teams have spent time building clever costing systems. The marketing teams, however, are only finding their feet but the most advanced are starting to establish marketing databases with campaign management tools, some modeling and *ad hoc* query capability.

Union Bank of Norway had the vision to move “from being one bank into a million banks – one for each customer.” As soon as a customer walks into a branch of UBN he or she is treated like an individual. Customers swipe their bank card through a terminal and are issued with a rather special numbered queuing ticket. This ticket links directly to the bank's data warehouse, which instantly identifies the customer and sends a message back to say just who is waiting. From this point on the customer is more than just a number. A video screen above the teller booths shows advertisements tailored to that customer – for example, if the transactions



stored in the data warehouse show that the customer has applied for a mortgage, the video screen might run an advert for home insurance.

In a similar vein, Wells Fargo has put in place its first steps toward offering individualised ATM advertising to its customers. It is in effect leasing screen space to third parties. Advertisements appear on the welcome, wait and thank you screens during all ATM transactions. The ads can be changed daily and different ads can be sent to different machines, thus permitting localised advertising. Wells' eventual ambition is to target advertisement messages to customers based on the demographic and financial information the bank maintains in its customer databases.

An increasing number of companies are using integrated voiced recognition (IVR) and voice recognition systems (VRS) at the customer interface. While this may seem efficient on paper, it often means that callers to a call centre have to endure 3 minutes of music before getting through to a human voice. Many of the calls are "purchasers-in-waiting".

Brand loyalty – that emotional connection with customers is built on the front line – face-to-face, on the phone and over the internet. For Bank One, the approach is to deliver the right experience when focused on the five customer "touchpoints", serving the customer with the values of what they call "I CARE". I CARE is an acronym for

- Inquire – ask questions to identify needs or concerns
- Communicate – assure customers that we are eager to meet their needs
- Affirm – confirm abilities and desires to get the job done
- Recommend – suggest a range of options
- Express – let the customer know we are personally committed.

In short, financial services organisations will want to know who their best customers are, how to keep them and how to increase their "share of wallet" by knowing what other service or product they can sell to them. They will want to have a customer-centric or one-to-one relationship and to increase shareholder value. But this all boils down to managing customers and potential customers more effectively. To do this you require information that can help make the best decisions to create and manage the right relationships, risks, costs and markets. If financial organisations understand how customers behave and how they prefer to interact, they can redesign core product offerings and devise appropriate channel strategies.

Management of the total enterprise

The experience with early CRM forays is that it is imperative to have total front office/back office integration. Customer-facing functions such as sales, marketing, call centres and other online support must become organisationally integrated with back office processes.

Unfortunately, many banks operate as a string of carefully shielded fiefdoms, using individual departments' software and systems to handle core functions that may or may not interact with other functional areas.

For example, account enquiries or automated clearinghouse (ACH) transfers may be processes on one system, stock trades on another, and international transactions on a third. These systems may run on separate mainframes and must be accessed through widely varying interfaces.

Consequently, solutions that have been implemented have been point solutions, aiming at automating only a specific piece of the overall process and disconnected from actions that precede or follow their one specific focus. Each step in the process requires information to be effective, and these systems, built as silos, do not have the ability to leverage shared information. The result is duplicated information, conflicting information, out of date information, and in general the inability to get all necessary information to all relevant parties when needed. Organisations are increasingly moving from data-centric point solutions to customer-centric enterprise solutions.

The securities industry, for example, is engaged in a massive effort to automate and speed up the process of clearing and settling trades – a concept referred to as straight through processing (STP). The objective is to squeeze the settlement period down from three or more days after trading (T+3) to one (T+1). In many institutions back office staff often have to deal with 15% or more exceptions – for example, trades that fail to settle smoothly. Usually these trades fail because data is missing or inconsistent, or conformations do not arrive or match, or the trades contravene some rules or other.

Many institutions have increasingly looked to outsource their back office operations, yet the back office can be considered as a rich source of information that could be packaged in a wide variety of high-value services for customers. Equally, it is an information-rich mirror of the entire industry value-chain that the bank could be uniquely positioned to help streamline.

Conclusions

The oft-made statement that all economies need a banking system but not necessarily banks is beginning to come to fruition. Many players in today's financial services industry are non-banks and non-financial service organisations; just look at players like Marks & Spencer, AT&T, Intuit, General Motors, Virgin and British Gas. Consumer electronics giant Sony have recently announced their intention to provide online financial services through their Dreamcast electronic games consoles.^{xviii}

Today, banks are no longer *gatekeepers* but *gateways* to financial products.^{xlix} In the old gatekeeper model, the bank functioned as an inhibiting intermediary that restricted a customer's set of product choices. In the new gateway model, the bank functions as a flexible intermediary that provides access to an entire spectrum of products and delivery channels. Some of the products – insurance, entertainment, travel, investment management – may not even originate within the bank but instead be provided by third parties. It is possible that banks will be one type of trusted portal, part of people's personal connection to e-

commerce. Institutions that fail to keep up with the online revolution are likely to find themselves regulated to supplying financial commodities to intermediaries.

While IT plays a vital role in CRM, as with all IT investments it should be driven by a strategic management perspective. Too often, companies seek to build CRM capabilities by designing a powerful IT system without considering wider business issues. In this paper we have developed a framework which can help in providing guidance for this process which is summarised in figure 3.

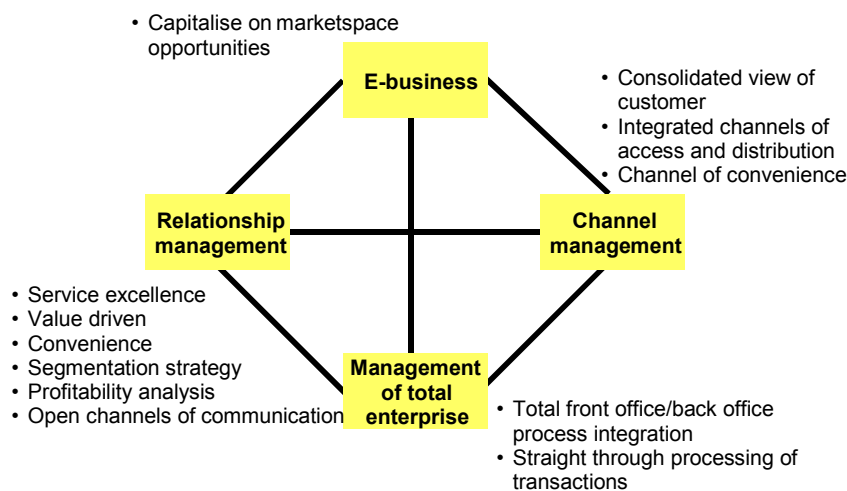


Figure 3 An integrated perspective of ECRM.

This figure illustrates the interdependent nature of e-business, channel management, relationship management and enterprise integration in becoming customer focused. It highlights that before embarking on any initiative, the scope must be broadened from just focusing on relationship management. In the e-business world, success is about owning the customers' total experienceⁱ and this is premised on understanding the customer and customer behaviour.ⁱⁱ Customers expect to interact with an institution through any channel, whatever is convenient for them, and receive instant, high-quality personalised service. The customer's experience in transacting business is important and the channel should be aware of the history. Technology should be used to create value for customers.

Integrated information is paramount for successful management of customer relationships. Information is the essential enabler when based on scalable technology as the platform – that is, information is centrally managed enterprise-wide, registers as the 'one version of the truth' and provides a consolidated view of the customer across all channels and products.

To manage the transition to becoming a customer-centric organisation, organisations must develop the capabilities to acquire the key resources, knowledge, and tools that can help them match customers with

appropriate products and services. Unfortunately, many banks have a culture that may be inconsistent with the desire to organise around the customer, and a set of processes that are siloed along product lines instead of customer lines. Furthermore, they have a legacy of customers – many of whom are unprofitable - and an inability to properly develop strategies that will give all segments of the customer base the service that suits them.

Traditional financial service companies also struggle with the cultural, organisational and technological challenges associated with becoming customer-focused enterprises. The sheer size and historical baggage of traditional financial institutions can have a negative implication in the new ecology. In many banks, the branch is the central point of reference: accounts are held there.

It is very likely that in the future banks will need to use their distribution networks to sell non-financial products if they are to remain competitive. In the UK there have already been examples of successful collaborations between financial and non-financial organisations. Barclaycard and Cellnet, for example, offered customers cellular telephones linked to Barclays' loyalty scheme. Barclaycard has also partnered with gas utility Eastern and the Ford Motor Company.

Speed is of the essence when competing in the new ecology and this has implications for the IT function. WingspanBank was established by Bank One in a very short timescale. In January 1999, a small team was charged with building a full-service online bank. By February, the group was ready to build the bank. They met with vendors to finalise hardware and software choices and simultaneously put the company together. The team started development immediately, testing was completed in April and went live in June.ⁱⁱⁱ

Technology and the new economy offer tremendous opportunities for existing bricks-and-mortar organisations. There are many, and the ecosystem is being continually defined and refined. There is, however, the danger that the organisation neglects the basics. Competing in the marketplace does not mean that the past is irrelevant. Many of the attributes that made the organisation successful in the past are still crucial. Organisations still require strong leadership. The right structures and processes must be put in place; the right people with the right skills, attitudes and competencies hired and deployed appropriately; technology must become part of management "theory of business". All must be incorporated within a sound strategic business perspective.

The case of Bank One is worth recounting. Despite being an internet pioneer with its online bank, WingspanBank.com the institution has had some problems. In an interview in early 1999, the CEO stated "[s]ome one asked me what causes me to wake up in the middle of the night. It used to be bad loans. I don't worry about bad loans any more." He confessed that he worries about the internet.ⁱⁱⁱ In October later that year he lost out in a bank shakeout brought about by the poor performance of its credit card division due to bad loans! He eventually resigned in December.^{iv}

Web addresses of sites/companies mentioned in paper

Abbey National	www.abbeynational.co.uk
American Express	www.americanexpress.com
Banco Santander	www.bancosantander.es
Bank of Scotland	www.bankofscotland.com
Bank One	www.bankone.com
Bank 24	www.bank24.de
BankAmerica	www.bankamerica.com
Britannia Building Society	www.britannia.co.uk
Charles Schwab	www.schwab-europe.com or
www.schwab.com	
Citibank	www.citibank.com
Datek	www.datek.com
Deutsche Bank	www.deutschebank.de
DLJ Direct	www.dljdirect.co.uk
E*Trade	www.etrade.co.uk
Ebank	www.ebank.com
Egg	www.egg.com
E-loan	www.eloan.com
Fidelity Investments	www.fidelity.com
First Direct	www.firstdirect.co.uk
First USA	www.firstusa.com
First-e	www.firste.com
Halifax	www.halifax.co.uk
Homeshark	www.homeshark.com
InsWeb	www.insweb.com
Intuit	www.intuit.com
Lloyds TSB	www.lloydstsb.co.uk
Loan-By-Phone	www.loanbyphone.com
MeritaNordbanken	www.meritanordbanken.com
Midland Bank	www.midlandbank.co.uk
Mortgage.com	www.mortgage.com
Net.B@nk	www.netbank.de
Prudential	www.prudential.co.uk
QuickenMortgage	www.quickenmortgage.com
Security First Network Bank	www.sfnb.com
Barclaycard	www.barclaycard.com
TD Waterhouse	www.tdwaterhouse.co.uk
Tesco	www.tesco.co.uk
Virgin	www.virgin.com
Wells Fargo	www.wellsfargo.com
Wingspanbank	www.wingspanbank.com
Woolwich	www.woolwich.co.uk

[Contact FINEOS for a demonstration of FINEOS's CRM solution or for any queries you have about this white paper.](http://www.FINEOS.com/CRM/)

<http://www.FINEOS.com/CRM/>

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